13.02 Accounting for Income Taxes: Temporary Differences

Temporary differences represent differences between the tax bases of assets or liabilities and their reported amounts in the F/S (books) that will result in taxable or deductible amounts in the future. These differences will reverse over time. Goodwill is considered a temporary difference. The differences are reported as an asset or liability, resulting either in taxable or deductible amounts.

Deferred tax Liabilities (*taxable temporary difference* – **TTD**) are expected future tax liabilities that arise because future Taxable income is expected to be **greater** than future Book income due to these temporary differences. Examples include:

- Depreciation methods for tax and book may be different (accelerated depreciation for tax)
- Investments accounted for under the equity method for book, and cost method for tax. (More income for book today, so owe government money later)
- Accrual Sales for book, and installment sales method for tax (more book income today, owe government money later)
- Prepaid expenses (cash basis for tax).
- Goodwill (15 year amortization for tax and tested annually for GAAP)

Deferred tax Assets (*deductible temporary difference* – **DTD**) are expected future tax-deductible differences that arise because future Taxable income will be **less** than future Book income due to temporary differences. Examples include:

- Warranty expense for book today, but deductible for tax when you pay it (Tax expense is less today, so income is higher)
- Rent, Royalty & Interest received in advance is taxed when received, but for book, when earned.
- Credit loss expense – for tax, use direct write-off, for books an allowance approach.
- Contingent Liabilities

Book Expense < Tax Expense Book Income > Taxable Income	**Liability** (**T**axable **T**emporary **D**ifference)
Book Expense > Tax Expense Book Income < Tax Income	Deferred Tax **Asset** (**D**eductible **T**emporary **D**ifference)